S. HRG. 109–1052

EXTENSION OF HUD'S MARK-TO-MARKET PROGRAM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

EXTENDING HUD'S MARK-TO-MARKET PROGRAM AN ADDITIONAL 5 YEARS TO CONTINUE REDUCING SECTION 8 COSTS WHILE PRESERVING THE AFFORDABILITY AND AVAILABILITY OF LOW-INCOME RENTAL HOUSING ON THE MARKET

JUNE 14, 2006

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EXTENSION OF HUD'S MARK-TO-MARKET PROGRAM

WEDNESDAY, JUNE 14, 2006

U.S. SENATE,
SUBCOMMITTEE ON HOUSING AND TRANSPORTATION,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
Washington, DC.

The Committee met, pursuant to notice, at 2:42 p.m., in Room SD–538, Dirksen Senate Office Building, Hon. Wayne Allard (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. I call the Subcommittee on Housing and Transportation to order.

Congress created the Mark-to-Market program in 1997 to reduce Section 8 costs while preserving the affordability and availability of low-income rental housing. The purpose of the program is to reduce the property rents to market level while simultaneously reducing property debt levels and owner costs through a number of tools authorized through legislation. Studies seem to show that the program has been an overwhelming success.

Nearly 250,000 units of affordable housing have been preserved due to the Mark-to-Market program. This is affordable housing that would have been permanently lost as affordable otherwise, according to an ABT Associates study for HUD. As of July 30, 2003, the program had produced a net savings to taxpayers of about $831 million, using moderate assumptions of future portfolio performance.

The original legislation authorized the Mark-to-Market program for 4 years, which was subsequently extended for 5 additional years. Therefore, the Mark-to-Market program authority will expire on September 30 of this year, in 2006. When the program was extended in 2001, it appeared that 5 years additional would be sufficient time for nearly all eligible properties to complete the Mark-to-Market process. However, more recent projections show that nearly 78,000 properties will face rent reductions over the next 5 years.

It is important to note that even though the program will expire, these Section 8 properties with above-market rates will still be required to have their rents reduced to market levels. Without the proper tools to also restructure the debt, many owners will lack sufficient funds for property maintenance or mortgage payments. Because many Section 8 properties are also FHA-insured, this will

result in a significant number of claims against FHA, in addition to many tenant displacements.

Clearly, no one finds this a desirable scenario. Failure to extend the Mark-to-Market program would be bad for tenants and bad for taxpayers. Thus, I am pleased to join with Senator Reed in introducing Senate Bill 3511, The Mark-to-Market Extension Act of 2006. Our bill would extend the program for 5 additional years to allow the remaining properties to go through the Mark-to-Market process. Frankly, I can see no down side to extending the program. After all, it maintains affordable housing for less money.

In addition to our witnesses here today representing the National Housing Trust and the National Leased Housing Association, a broad coalition of groups has signed letters indicating their support for extension of the Mark-to-Market program, including the National Housing Conference, National Affordable Housing Management Association, Low-Income Housing Coalition, National Housing Law Project, Stewards of Affordable Housing for the Future, Enterprise Community Partners, Local Initiative Support Corporation, California Housing Partnership Corporation, the Chicago Community Development Corporation, American Association of Homes and Services for the Aging, Council for Affordable and Rural Housing, Institute for Real Estate Management, Institute for Responsible Housing Preservation, Mortgage Bankers Association, National Affordable Housing Management Association, the National Apartment Association, National Association of Affordable Housing Lenders, National Association of Home Builders, National Association of Realtors, National Multi-Level Housing Council, National Council of State Housing Agencies.

I am pleased to work with the groups and with my colleagues to see that this very worthwhile program is extended for an additional 5 years. I also would like to thank today's witnesses for their support of our efforts. They are all well respected in affordable housing circles, and their testimony will be helpful. First, I would like to welcome Mr. Ted Toon, who is the Deputy Assistant Secretary for the Office of Affordable Housing Preservation, referred to as OAHP, O-A-H-P. This is the office within HUD that administers the Mark-to-Market program.

Next, I would like to welcome Mr. Chris Foster, President of the National Leased Housing Association. Mr. Foster's organization has been at the forefront of the efforts to extend the Mark-to-Market program. In particular, I would like to acknowledge the efforts of Denise Muha, who has worked tirelessly to form the coalition in support of the extension.

Finally, I would like to thank Mr. Scott Kline of the National Housing Trust for appearing before the Subcommittee today. The National Housing Trust has also been extremely active in their campaign to reauthorize the Mark-to-Market program. They have been working quietly behind the scenes now for quite some time, and their expertise has been helpful.

Again, thank you to all of our witnesses for being here today, and I look forward to your testimony. Now, I would like to call on my partner and helper here on the Committee, the head of the minority side on this Subcommittee, Senator Reed from Rhode Island.

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you very much, Mr. Chairman, and thank you, gentlemen, for being here today.

I would first like to thank Senator Allard for scheduling this hearing on the extension of HUD's Mark-to-Market program. The original Mark-to-Market program was created in 1997 to address two key problems: the increasing cost of renewing project-based Section 8 rental contracts and the potential loss of tens of thousands of affordable rental properties threatened by the expiration of these contracts.

And there was a further complication, because, in fact, many of the Section 8 contracts that had 20-year terms were in buildings with 40-year FHA-insured mortgages. In most cases, the contract rents in these buildings, the FHA buildings and Section 8 buildings, were higher than local market rents, which were often not sufficient to allow the owners to pay their mortgages. In other words, without the Section 8 rents, these buildings would go into foreclosure and potentially cost the FHA hundreds of thousands of dollars.

In fact, according to an August 2004 evaluation of the program prepared by ABT Associates for HUD, the present value of net savings generated by the Mark-to-Market program is $831 million as of July 2003. The program has preserved about 200,000 units of housing. There are very few programs that can claim almost $800 million of savings and also maintaining such a prodigious number of affordable housing units. So it is a successful program, and I think Senator Allard and I want to follow up in ensuring its success and its continuity.

And because of that reason, I am pleased to join Senator Allard as a cosponsor of S. 3511, the legislation to extend the Mark-to-Market program. Since circulating the bill, we have had some comments from interested parties that suggest a few more changes, and I look forward to working cooperatively with the Chairman to see if we can incorporate these changes. But this is a program that works; it is a program that is necessary, and it is a program that I hope we can very quickly extend.

Thank you very much, Mr. Chairman.

Senator ALLARD. Thank you very much, Senator Reed.

Now, I thought we would start on my left, your right, and start with Mr. Toon, then Mr. Foster, and Mr. Kline, and we allow 5 minutes for testimony.

STATEMENT OF THEODORE K. TOON, DEPUTY ASSISTANT SECRETARY, OFFICE OF AFFORDABLE HOUSING PRESERVATION, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. TOON. Thank you. Good afternoon. Thank you, Chairman Allard, Ranking Member Reed, for inviting me here today to testify on the proposed Mark-to-Market Extension Act. The preservation of affordable housing in our communities is a top priority for Secretary Jackson, Assistant Secretary Montgomery and the Department of Housing and Urban Development.

The Mark-to-Market program, as you mentioned, was originally created in 1997, extended in 2001, and will expire in September

2006. And the bill that you have introduced will extend the program an additional 5 years. As you are aware, under Mark-to-Market, HUD has the mandate to reduce the rents to market levels, saving dollars on project-based Section 8 expenditures. It also includes authorities that are essential to maintaining the physical and financial viability of these properties at the reduced rents.

In Mark-to-Market, HUD analyzes the rents, the repair needs, the property viability, and if necessary, resizes the FHA-insured mortgages to a level that can be serviced by the reduced market rents. If the debt is resized, the owner enters into a new long-term use agreement, keeping the property affordable for the next 30 years.

Over the past 9 years, HUD has been very successful at balancing the dual program goals of reducing the subsidy costs while preserving affordable housing. To date, we have preserved over 2,200 properties around the country, with 188,000 affordable housing units, and in so doing, we have promoted the long-term physical and financial viability of this affordable housing. The program, as of this month, in fact, has surpassed $2 billion in net savings to HUD and the American taxpayers, and by preserving this housing, we have provided stability for the many low-income families and the communities where they live.

In discussing an extension of the program, I think it is important to consider what has been achieved thus far. To date, the program has preserved properties in all 50 States and the District of Columbia; for example, Chairman Allard, in Colorado, HUD Has preserved 31 properties with 1,800 units of affordable housing; in Rhode Island, 12 properties with more than 1,000 units have been preserved, and another 21 properties with more than 2,000 units will become eligible under this proposed extension.

But not every property can or will be preserved through Mark-to-Market. While preservation is a primary goal, Congress made it very clear that prudent use of limited resources was an equally important goal, and we have taken this charge seriously. There have been and will continue to be properties referred into the program that simply cannot be responsibly preserved. These properties may be too expensive or functionally obsolete. They might be located in markets that have ready availability of replacement housing, or the property ownership may simply be unable or unwilling to move forward with the transaction.

According to our analysis of potential future referrals, if the program is extended as proposed, nearly 800 additional properties, or 78,000 units, as you cited, will meet the eligibility requirements for restructuring. This is the universe of properties that, absent extension of the restructuring authorities, will represent the most at-risk properties in HUD's insured mortgage portfolio, and this is because MAHRA will continue to require the markdown of the rents but will not allow the concurrent restructuring of the underlying mortgage. The reductions in rents to market levels will result in properties being unable to pay operating costs and mortgage payments. In addition to the lost opportunity to preserve additional 800 properties, the sunset will expose the FHA insurance fund to considerable default and foreclosure risk, estimated at about $400 million over the 5-year period.

I want to conclude today by pointing out that Congress' intent in creating originally the Mark-to-Market program and then extending it was that the long-term costs had to be reduced and that it would be less expensive and more effective to proactively address the physical and financial challenges facing the properties than to wait for them to physically decline and financially fail, and this has been proven true by the successful restructuring of 188,000 units across the country and also helped improve the lives of thousands of low-income families who call these units home.

Thank you for inviting us here to testify today. On behalf of the entire Department, I look forward to continuing to work with you to ensure that we provide affordable housing in a cost-effective manner.

Thank you.

Senator ALLARD. Mr. Foster.

STATEMENT OF CHRIS FOSTER, PRESIDENT, NATIONAL LEASED HOUSING ASSOCIATION

Mr. FOSTER. Thank you very much, Mr. Chairman.

Mr. Chairman and Senator Reed, thank you very much for having me today to testify on this legislation to extend HUD's Mark-to-Market restructuring program. As you said, my name is Chris Foster, and I am President of Hampstead Partners and outgoing President of the National Leased Housing Association at this time, NLHA, which is a trade association located here in Washington, D.C.

NLHA strongly supports the extension of the Mark-to-Market program. It is a valuable tool that, as has been cited, has preserved approximately 200,000 affordable apartments. The Mark-to-Market program applies to properties insured by the FHA, with project-based assistance, primarily under Section 8 of the 1937 Housing Act, with rents in excess of market in the area.

Notwithstanding the fact that many of these properties had originally been built with rents which were set above market at the time, when the first wave of the 20-year Section 8 contracts approached expiration in the mid-1990s, Congress was reluctant to authorize renewal of the contracts at above-market rents. Many of these projects could not operate and meet mortgage payments at market rents.

This universe of projects lent themselves to a solution which, as has been indicated today, actually has a positive budget impact. In addition, needed rehabilitation and the replenishment of reserves is generally accomplished under the program and is necessary.

Owners of projects that have been restructured must execute use agreements to accept Section 8 renewal offers and keep rents affordable with or without availability of Section 8 assistance going forward for the next 30 years. We understand in the coming years, a significant number of Section 8 contracts will be eligible for initial renewal and that many are attached to projects with HUD-insured mortgages. The Housing Trust, which is sitting next to me, has indicated that almost 1,000 properties will be eligible for the Market-to-Market program in the next 5 years.

The same factors that moved Congress to enact the program originally still exist today. We urge Congress to authorize the 5-

year extension and have attached for the record an industry letter signed by 15 national housing organizations that endorse the extension. My company, Hampstead Partners, has been involved in restructuring several hundred units under the program. The program has made it possible to both preserve and add tens of millions of dollars in additional non-FHA funds to these projects for rehab and preservation purposes. In fact, we are just now initiating the processing of several hundred more units in Baltimore.

The bill proposes two changes to the Mark-to-Market program that we strongly support. The bill suggests increasing from 5 percent to 9 percent the total number of units that can have exception rents. Exception rents are rents that exceed market and are used when no amount of debt restructuring can yield viable rents below market. The second change extends the period during which a nonprofit purchaser of a Mark-to-Market project can obtain debt relief on a second mortgage. Such a change is necessary in order to recognize the reality of the time it takes to process real estate transactions.

We recommend adding a provision to the bill to give owners of properties that have undergone debt restructuring the right to request and receive budget-based rent increases. Such rent increases are authorized in the Mark-to-Market regulations but are discretionary with HUD, and the Department has determined not to entertain any requests for budget-based rent increases thus far, relying instead solely on annual operating cost adjustment factors, OCAFs.

Over the 30-year life of the program, it is possible that for some properties, the OCAF adjustment will be insufficient to meet rising operating costs, which does not necessarily reflect additional operating cost increases, particularly because OCAFs are published on a Statewide basis.

The bill also proposes one change in the authorizing statute that moves the program into new areas which we are not able to unequivocally support at this time. The bill, as drafted, would give HUD unilateral authority to require Section 8 projects with HUD-insured mortgages but with below-market rents participate in the Mark-to-Market program. This is a major departure from the program. While this could be an excellent workout tool, we believe that participation in the program should and must be voluntary, as it is now. I have spoken with Mr. Toon earlier today, and he indicated at that time that he was in agreement the participation should be voluntary. I thank you very much for your time and consideration, and I will be happy to answer any questions.

Thank you.

Senator ALLARD. Thank you.

Mr. Kline.

STATEMENT OF SCOTT KLINE, VICE PRESIDENT AND DEVELOPMENT DIRECTOR, NATIONAL HOUSING TRUST

Mr. KLINE. Thank you, Chairman Allard, Ranking Member Reed, and Members of the Subcommittee. Thank you for inviting the National Housing Trust to participate in the hearing today. We appreciate the opportunity to comment on the bill, as introduced by Sen-

ator Allard, to extend the Mark-to-Market program of the Department of HUD.

My name is Scott Kline. I am Vice President of the National Housing Trust, a national nonprofit organization formed in 1986 dedicated exclusively to the preservation and improvement of affordable, federally assisted and insured housing. The Trust was deeply involved in the introduction of the Mark-to-Market legislation nearly a decade ago, and we continue to view the program as an essential tool for preserving affordable housing today.

I also serve as the head of NHT Enterprise Preservation Corporation, a housing development corporation that has used the Mark-to-Market program to successfully save affordable housing. NHT Enterprise owns and operates nearly 3,000 affordable apartments in Illinois, Texas, Florida, South Carolina, North Carolina, Virginia, and the District of Columbia.

Mark-to-Market reauthorization is urgently needed, and NHT strongly supports the bill introduced by Senator Allard. The National Housing Trust has joined more than a dozen national housing groups in signing a letter of support supporting reauthorization. The Mark-to-Market program preserves and improves affordable HUD-subsidized housing through a restructuring of debt and lowering of Section 8 contract rents. The program places HUD-subsidized properties on a steadier financial platform from which they can be soundly operated with renewed long-term affordability.

Currently, an estimated 92,000 units in more than 1,000 FHA-insured properties have above-market rents. Most of these properties, however, have contracts that will expire after Mark-to-Market is scheduled to sunset. No one disputes that the program has saved affordable subsidized housing. As of February 2006, according to HUD, the program had saved over 220,000 affordable apartments. Nor is there any real dispute that it saved taxpayers money. In April 2006, the GAO issued a report that describes Mark-to-Market as one of the steps HUD and the Congress have taken to limit cost of growth of the Section 8 program, and as both of you mentioned in your opening remarks, the program is estimated to have saved up to $833 million in savings since it was authorized in 1997.

The HUD finding of $833 million in savings is consistent with historical Mark-to-Market cost estimates. In 2001, the CBO found that the cost of restructuring mortgage debt is less expensive than the cost of default by about $1 million per project. Exception rents are also a vital preservation tool, and this is something I want to emphasize. The Senate bill lifts the exception rent cap up to 9 percent of the properties closed under the program in any given year. NHT Enterprise was recently involved in a transaction that could not have occurred without exception rents. In June 2005, NHT Enterprise closed on the financing of a 67-unit, 100 percent Section 8 scattered-site property located in the South Shore neighborhood of Chicago. The properties, known as the O'Keefe portfolio, were acquired and renovated using financing and pursuant to the program requirements of Mark-to-Market.

The South Shore neighborhood is a middle-class neighborhood. The portfolio includes vintage 1920s brick multifamily neighborhood buildings, and there is a strong conversion market for these

types of walkup buildings. Absent the program and its allowed use of exception rents, these 67 affordable apartments could have been converted to market-rate housing. Rehabilitation and repair work financed under the Mark-to-Market restructuring included both interior and exterior repairs necessary to ensure a decent, safe, and quality living environment, and we also added a computer lab for residents to use.

The Trust also supports the provision that extends the period of eligibility for nonprofits to receive debt relief when acquiring a Mark-to-Market property. The original Mark-to-Market bill encouraged transfers to qualified nonprofit organizations. There is mounting nonprofit interest in ability to purchase individual properties in the portfolio of restructured properties. Nonprofit sponsors accessing programs such as Home CDBG, tax-exempt financing, and Low Income Housing Tax Credits annually produce or preserve over 30,000 units of affordable housing. HUD limits the time a nonprofit may secure debt relief or assignment of debt on a Mark-to-Market property to 3 years after the property closed under the program.

However, the Mark-to-Market program is nearly 10-years old. With each passing year, qualified nonprofits are prevented from pursuing the elimination of debt in more and more properties that have previously gone through Mark-to-Market. Without debt relief or assignment, these transactions are infeasible. This 3-year rule significantly limits the options of private owners. Many owners are willing to transfer the properties, but they are blocked from receiving a fair market bid by the 3-year limit.

The current 3-year limit on these nonprofit purchase incentives is arbitrary. If the best outcome of the sale is transfer to a nonprofit purchaser, then, the Secretary should have maximum flexibility to support that outcome. The Senate bill appropriately addresses this policy flaw, permitting nonprofits to purchase a Mark-to-Market property on or before the latter of 5 years after recordation of the affordability agreement or 2 years after enactment of the bill.

Again, thank you for providing us with the opportunity to comment on this very important bill.

Senator ALLARD. I want to thank you all for your testimony. It has been very helpful. My first question, and I direct this to all of the witnesses, and I think you addressed this in your testimony, but I just want a straightforward answer for you for the record: which will save more money in the end, extending the Mark-to-Market program or allowing it to expire? And I will let you, Mr. Toon, start that out, and then, if Mr. Foster and Mr. Kline respond.

Mr. TOON. As Mr. Kline mentioned, the cost of a default and foreclosure is considerably more expensive by somewhere in the neighborhood of $1 million a project more expensive than doing a restructuring.

Senator ALLARD. Mr. Foster.

Mr. FOSTER. Well, no question; I agree with Mr. Toon on that, and moreover, I would like to say the cost to the families of not preserving these projects is perhaps even worse.

Senator ALLARD. Good point.

Mr. Kline.

Mr. KLINE. We agree, of course, with everything. It is a financial savings as well as a social savings.

Senator ALLARD. Now, Mr. Toon, in your testimony, I note with interest your commitment that you had made to previous Congresses that you would administer the program in a way in which you respected the integrity of the budget. I do not recall your exact words on that. And I assume that we will have that same commitment on this particular piece of legislation that will continue through for the next 5 years?

Mr. TOON. Absolutely.

Senator ALLARD. Mr. Foster, you wanted to allow the operators of the units that went into Mark-to-Market to have the authority to adjust those rentals to the rate without going back to HUD and getting approval. How can HUD and particularly the administrators of the Mark-to-Market program keep their commitment to the Congress if we just give this to the property owner to do this unilaterally?

Mr. FOSTER. What we want is the right to request a budget-based rent increase in some cases rather than using OCAFs, which we believe, in some select markets, may not be applicable to the long-term, and sufficiently recognize cost increases. We believe that OAHP will still have the authority to make the judgments as to when those types of adjustments will be applicable and will do so responsibly.

Senator ALLARD. I think you see my concern, and I think that we will continue to keep your thoughts in mind as we continue to work through this legislation, but I certainly do want to be sure that we keep this program, you know, historically sound, and that is what has made it easy for us to get this renewed year after year, because the Members of the Congress and everything, I think, agree with the testimony that we have heard here today as a general rule, that it is working, and it is working well, and it is saving taxpayer dollars, and it is providing housing where otherwise it would not be available for people who need it.

So that is the point that I wanted to make as we move forward on here.

Mr. FOSTER. Could I point out, Senator?

Senator ALLARD. Yes, go ahead, Mr. Foster.

Mr. FOSTER. Just to point out that the same conditions would exist a year or 2 or 5 from now, that default would be more expensive than fixing the problem going forward. So those same issues——

Senator ALLARD. Well, my only point is that we need to have some oversight, and I think we have to have fairly rigorous oversight so the program does not get out of control, and that is the point I am trying to make, and I think we can reach that. We want to make sure that it continues to be successful.

The other question: which will provide more affordable housing, extending the Mark-to-Market program or allowing it to expire? And I would like to have each of the three of you answer that one. The previous question I had was which will save more money in the end. And then, this one here, what will provide more affordable housing?

Mr. TOON. Again, a restructuring clearly will provide more affordable housing. Allowing the contracts to expire opens the options to owners that opting out of the program, for example, and taking their properties to market rate and out of the affordable stock is a risk that we have seen. And having this program, which provides market-oriented business incentives for them and for those properties ensures that they stay in the affordable portfolio.

Senator ALLARD. Mr. Foster?

Mr. FOSTER. I will not comment necessarily on the way that OAHP might deal with the issues, but I will just say in general it has been my experience as a developer that it costs somewhere around $70,000 on average to save and preserve a unit, and it costs well over $100,000 to build a new unit. So I would think it would be much more affordable.

Senator ALLARD. More affordable housing.

Mr. FOSTER. More affordable.

Senator ALLARD. Mr. Kline.

Mr. KLINE. We agree that continuing of the Mark-to-Market program would retain more affordable housing. It is more likely that more owners will opt out without the possibility of having a restructuring opportunity.

Senator ALLARD. Now, having made those comments, can any of you think of any down side to extending the Mark-to-Market program?

Let the record reflect no; is that right?

[Laughter.]

Senator ALLARD. Okay; very good.

Now, let me go ahead and call on my esteemed colleague, Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman, and thank you, gentlemen, for your testimony.

Mr. Toon, there is always a tension between programmatic initiatives and budget possibilities. We understand that. But your office is the one that is charged more than anyone else with preserving affordable housing. And I will state the obvious: in every community in this country, that is one of the biggest crises that we have, and it is not just at the low level; I think both Senator Allard and I have been visited by doctors all this week, and one of the concerns they have in terms of practicing in different communities, in some places, it is too expensive for them to have the kind of house that they can get elsewhere. So this is a huge problem.

Having said that, you mention the successes in Rhode Island, but there are at least two units, Colony and Medina Village, that both the PAE, the participating administrative entity, and the local HUD office recommended to you, your office, not you personally, your office, to make an exemption, exception for the rents, and you had turned down. And that seems to me, knowing the market up there is not the most proactive posture to preserve affordable housing. In addition, we have another unit, Barbara Jordan, which you are probably aware of, which the State is struggling to maintain the Section 8.

I would like you to sort of commit that not only on these issues but generally speaking, your office is going to be the real advocate,

the one that will go the furthest to preserve Section 8 housing. Is that something you can say?

Mr. TOON. It is, and I believe, in fact, that we have done so. The flip side of that, as Chairman Allard suggested, is that we are also ultimately charged with the fiscal responsibility, and at some point, some properties, unfortunately, are simply too expensive. And at that point, we can look at other options, such as moving those contracts to other properties in the same market, so there is no net loss of units. But we have been the most responsible with the limited resources we have.

Senator REED. Well, I will take up the point that Mr. Foster made is that there might not be any net loss in terms of units, but there are certainly disruptions in the lives and the families and then the communities, really, and I think also, too, it is this notion that it might be too expensive, again; ultimately, if these projects fail, you go back to the logic underlying the Mark-to-Market program. The cost of default on the mortgage, the cost of just the disrepair and everything else usually is much more. So I would urge you to be much more aggressive, although there is always a budget.

Let me turn to another issue which I think is important, which is Section 514, the Mark-to-Market statute. It requires the Secretary to spend up to $10 million annually for the provision of technical assistance to tenants in buildings where the Section 8 contracts are expiring. I am informed that HUD has obligated none of these funds for the past 4 years. Now, this is, as I understand it, a requirement to do so, and you are not doing it, and then, in cases where you have done it, almost retroactively, these funds have been sort of taken away from these purposes, even though there are people in good faith who thought they had a grant for 3 or 4 years.

Congress has already twice directed HUD to spend 514 funds in all expiring Section 8 contract buildings. Why have you not implemented Section 514 as the law requires and as Congress has insisted?

Mr. TOON. First, I would like to say that we absolutely support tenant involvement and input in the restructuring process. I believe it is a cornerstone of the program. Tenants often know the physical issues facing a property. They know the management issues. They are our best ally and our best partner in going through the restructuring process. And in fact, as you have said, the law requires tenant participation, and we have taken that seriously.

Section 514, in fact, says that the Secretary shall spend up to $10 million, so there is a discretionary component to it. For the last 4 years, the funds for that program, in fact, have not been appropriated, so there has been no funding to fund those programs.

There also were some issues with the earlier grants under 514. While certainly, there were some success stories there, and I think they really filled a gap in terms of getting tenant involvement, during that time, we have also charged our PAEs and our staff with a much higher degree of requirement in terms of getting tenant involvement. There are strict tenant notice requirements. Tenant meetings are required to be held at each property at least twice through the restructuring process to get support. Before we will ap-

prove a deal within our office, we ensure that the tenant comments, in fact, have been incorporated in the final plan. So there are a number of controls in place that ensure that tenant input is considered in the final plans that we are developing.

So we really feel that through the PAE structure, we are more than adequately including the tenant concerns, including tenant involvement, and ultimately making that a part of the restructuring.

Senator REED. Just as a follow-up, have you requested funding? Have you put it in your budget, the Section 514?

Mr. TOON. I am not aware of that, but I can get back to you for the record.

Senator REED. Please. I think that is important. I mean, as you can see, that is part of this legislation, and I think you indicated that tenant involvement is important, and it has to be something more than rhetorical; it has to be real, and I find usually, when you provide resources, it becomes less rhetorical, more practical, more real.

Let me, if I can, ask one question for Mr. Foster and Mr. Kline. My time is expiring. You have both, I think, in your testimony supported the notion of budget-based rent increases, and we have had a dialogue with the Chairman. I presume that the same logic underlying the budget-based is the logic that is in the overall program, which is this ends up saving money and saving units. Is that correct, Mr. Foster?

Mr. FOSTER. That is my point, yes, sir.

Senator REED. And Mr. Kline.

Mr. KLINE. Yes, we feel the same way. There are circumstances over a 30-year period where expenses may rise to such an extent that OCAF just does not cover what is necessary to rent and operate a property, and going back to some of the other studies that we made reference to in our testimony, keeping the property affordable and retaining it is cheaper than foreclosure.

Senator REED. And final question if I may, Mr. Chairman. I think there is a disagreement of opinion between Mr. Foster and Mr. Kline about below-market rates, being able to deal with properties below-market rates. Might you just a quick thought, Mr. Kline and Mr. Foster, about this approach?

Mr. KLINE. We feel that there might be circumstances that arise where the current Section 8 rents are below market, but in order to support the debt necessary to fund repairs, the rents might need to be hiked up above-market rents and that Mark-to-Market should be an available resource to do that.

Senator REED. And again, the logic is, and I presume you could show project by project that it saves units and would preserve affordable housing.

Mr. KLINE. Yes, sir, because otherwise, without the rehabilitation, the units are left to deteriorate, or the owners are going to have to opt out due to their inability to make REAC inspections.

Senator REED. Mr. Foster, you have a divergent opinion?

Mr. FOSTER. Actually, no, sir; we think it is attendant upon the Department to find that it would save money ultimately, or else, they cannot do it to begin with. But secondly, generally, we are not in disagreement that we could not have—that they should not have that tool. We are simply saying that it needs to be voluntary. In

other words, the owners need to agree that they are going to come into the program——

Senator REED. Okay.

Mr. FOSTER.——as well as OAHP saying that they should come into the program, and we are willing to work with OAHP to come up with some language, and we just think that the language needs to be thoroughly vetted.

Senator REED. Thank you very much.

Thank you, Mr. Chairman.

Senator ALLARD. Thank you. Finally, I just have one question. Do you have any more questions?

Senator REED. No, I do not.

Senator ALLARD. I just have one question, and this is to Mr. Toon of HUD.

Would you not agree that there is a very real and quantifiable down side to not extending the program?

Mr. TOON. There is. The most important and obvious is the default and foreclosure risks to the FHA insurance fund, which our risk analysis office has estimated at $400 million over 5 years.

Senator ALLARD. Okay; and then, you reminded us that it is $400 million.

Mr. TOON. $400 million, with an M.

Senator ALLARD. And what would $400 million in default mean to FHA?

Mr. TOON. It would be devastating.

Senator ALLARD. Okay; any other questions? If not, we will call the hearing to a close. Oh, I have got some more questions here. Let me do it this way: we have got quite a few questions here, and we could spin this out for quite a length of time. What I would like to do is I would like to write these out to you, and we will send them to you.

Mr. TOON. Certainly.

Senator ALLARD. And then, can you all respond back within 10 days?

Mr. FOSTER. Yes, sir.

Mr. KLINE. Yes, sir.

Senator ALLARD. We would appreciate it if you could, and then, we can get the legislation moving.

Mr. KLINE. Absolutely; yes sir.

Senator ALLARD. Okay; thank you very much. The hearing is adjourned.

[Whereupon, at 3:20 p.m., the hearing adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF THEODORE K. TOON

DEPUTY ASSISTANT SECRETARY, OFFICE OF AFFORDABLE HOUSING PRESERVATION
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

JUNE 14, 2006

Thank you Chairman Allard, Ranking Member Reed, and members of the Subcommittee for inviting me here today to testify on the proposed Mark-to-Market Extension Act. The preservation of affordable housing in our communities continues to be a top priority for Secretary Jackson, Assistant Secretary Montgomery and the Department of Housing and Urban Development (HUD).

The Mark-to-Market program, originally created by Congress in 1997 (the Multifamily Assisted Housing Reform and Affordability Act (MAHRA)), and extended in 2001 (the Mark-to-Market Extension Act), reduces rents to market levels upon Section 8 contract expiration and renewal. HUD contracts with private owners of rental units to help ensure a certain number of units for occupancy by low-income residents. When those contracts expire and are renewed, if the contract rents are found to be above comparable market rents for similar units in the same area, the Mark-to-Market program reduces the new contract rent for those units to market levels. By bringing above-market Section 8 rental rents in line with market levels, HUD controls costs of the Section 8 program and maximizes the number of families that can be helped by such housing assistance. The Mark-to-Market authorities will sunset September 30, 2006. The bill that you have introduced, Mr. Chairman, proposes a 5-year extension of the existing Mark-to-Market restructuring authorities, administered by HUD.

As you are aware, under Mark-to-Market, HUD has the mandate to reduce rents to market levels, saving dollars on project-based Section 8 expenditures. Mark-to-Market also includes authorities essential to maintaining the physical and financial viability of the properties with reduced rents. In Mark-to-Market, HUD staff oversees a network of public and private entities to analyze property viability, recommend repairs and other preservation activities, and, if necessary, re-size the FHA-insured debt to a level that can be serviced by the reduced rents. If debt is re-sized, the owner enters into a long-term use agreement through which the property is preserved as affordable housing for at least 30 years. To be sure, this is a significant tool in HUD's preservation toolbox. Unfortunately, HUD's mandate to reduce rents will continue beyond September 30, 2006, but the Mark-to-Market authorities will not.

Over the past 9 years, HUD has been very successful at balancing the dual Mark-to-Market program goals of reducing long-term Section 8 subsidy costs while preserving affordable housing. To date, HUD has preserved 2,200 properties around the country comprising over 188,000 affordable housing units, and in so doing we have promoted the long-term physical and financial viability of these properties. The program has generated net savings totaling $2 billion to HUD and the American taxpayers. And by preserving affordable housing, we have provided stability for many low-income families and the communities where they live.

In discussing reauthorization of Mark-to-Market, I think it's important to consider what has been achieved thus far. To date, this program has preserved properties in all 50 states and the District of Columbia. For example, Chairman Allard, in Colorado, HUD has preserved 31 properties with 1,800 units of affordable housing. In Rhode Island, Senator Reed, 12 properties with more than 1,000 housing units have been preserved, and another 21 properties with more than 2,000 units will become eligible under this proposed extension. (Attachment A shows the number of properties and units preserved through and active in Mark-to-Market, and the potential referrals over the next 5 years.) Once restructured, these properties are physically improved and on solid financial footing. That is a "win-win" situation for the tenants and the community.

Not every property can or will be preserved through Mark-to-Market. While preservation is a primary goal of the program, Congress has made it very clear that prudent use of limited resources is an equally important goal. HUD has taken this charge seriously. There have been, and will continue to be, properties referred into Mark-to-Market that simply cannot be responsibly preserved. These projects may be too expensive, functionally obsolete, or located in markets with ready availability of replacement housing.

In other situations, properties that in the Department's opinion require restructuring do not receive the benefits of the program because the owners refuse to accept the terms of the restructuring. In these cases, HUD makes the determination that the project is infeasible for restructuring. These are difficult decisions, made with consideration of the needs of the affected residents and communities, and with

cooperation from both our office and the HUD field offices. Properties that need restructuring but don't accomplish it are closely monitored by HUD to allow early intervention if the property deteriorates. The analysis done while in Mark-to-Market informs and shapes the Department's decisions on other management options for the properties thereafter.

Now, let us turn to the discussion before us today, which is the proposed reauthorization of Mark-to-Market. According to the Department's analysis of potential referrals, if Mark-to-Market is extended as proposed in this bill, over 5 years (FY 2007–11) nearly 800 properties with 78,000 affordable units will meet the eligibility requirements for Mark-to-Market restructuring. These are project-based Section 8 properties with expiring Section 8 contracts, FHA-insured mortgages, and contract rents above Fair Market Rents. This is the universe of properties that, absent extension of restructuring authorities, will represent the most at-risk properties in HUD's insured mortgage portfolio because of the required reductions in rents.

In addition to the lost opportunity to preserve another 800 properties, or 78,000 units of affordable housing, the sunset of Mark-to-Market may also expose the FHA Insurance Fund to considerable risk. This is because MAHRA, the legislation that created Mark-to-Market, will continue to require that contract rents on subsidized FHA-insured properties get marked down to market levels upon contract renewal, regardless of whether the program is extended. Reductions in rents to market levels will result in many properties being unable to pay their operating costs and/or their mortgage payments. As we see with other properties in negative cash flow positions, these property owners and managers will be faced with the decision of paying for utilities and routine maintenance, or making their mortgage payments.

It is important to keep in mind that FHA insures the underlying mortgages on these properties. Not only will we see physical deterioration of the projects, which will negatively impact residents, and the overall communities, but the mortgages on these projects also represent real, quantifiable default and foreclosure risk to the FHA Insurance Fund—risk that is estimated to total more than $400 million over the next 5 years.

In conclusion, I want to thank you for affording our Department the opportunity to testify on this legislation. Congress' intent in creating and then extending Mark-to-Market was that long-term costs had to be reduced, and that it would be less expensive and more effective to proactively address the physical, financial, and managerial challenges facing our affordable housing portfolio than to wait for the properties to physically decline and financially fail. This belief has been proven true by the successful restructuring of 188,000 apartment units across the country, which has also helped improve the lives of thousands of low-income families who call these units home.

On behalf of the entire Department, I look forward to working with you to ensure that we continue to provide affordable housing in a cost-effective manner.

Attachment A - Testimony of HUD DAS Theodore Toon

	Completed*			**Current Pipeline****			**Potential Referrals*****	
State	# Properties	# Units		# Properties	# Units		# Properties	# Units
AK	8	414		0	0		0	0
AL	105	5,384		8	507		11	993
AR	26	2,077		3	354		20	1,580
AZ	18	1,270		0	0		1	225
CA	159	10,708		5	555		41	3,067
CO	54	2,873		6	603		11	1,385
CT	33	2,852		2	145		12	2,168
DC	28	2,988		3	316		1	302
DE	6	485		1	100		1	221
FL	121	10,899		5	517		6	819
GA	60	5,896		4	297		17	2,001
HI	12	918		0	0		0	0
IA	48	2,694		4	332		22	1,394
ID	10	226		1	56		2	72
IL	75	7,038		8	727		53	7,867
IN	91	8,221		10	967		37	3,934
KS	36	2,465		4	407		23	2,046
KY	171	10,933		9	560		24	2,463
LA	70	6,504		11	1,300		3	196
MA	48	4,166		4	360		23	3,032
MD	53	4,956		0	0		3	170
ME	9	544		0	0		1	140
MI	32	3,286		3	251		19	2,356
MN	15	689		1	36		18	1,131
MO	94	6,310		6	249		17	1,557
MS	105	8,298		7	775		7	650
MT	33	1,759		0	0		10	713
NC	78	4,504		17	747		35	1,987
ND	14	585		0	0		6	335
NE	15	492		2	61		11	584
NH	5	459		1	90		8	350
NJ	50	4,725		3	425		8	1,400
NM	18	1,068		0	0		3	182
NV	12	621		0	0		0	0
NY	272	28,287		20	1,974		55	7,030
OH	388	25,242		19	1,586		61	5,488
OK	54	4,368		2	226		12	998
OR	11	404		0	0		3	110
PA	174	13,901		7	580		38	3,235
PR	21	1,618		3	202		13	1,978
RI	32	1,811		2	147		21	2,050
SC	65	5,030		7	588		12	1,264
SD	19	786		1	44		5	170
TN	94	8,617		8	756		12	1,498
TX	132	11,758		9	1,271		26	3,554
UT	26	1,254		1	8		4	283
VA	37	3,098		1	100		5	296
VI	3	226		0	0		1	216
VT	2	124		0	0		3	183
WA	57	2,504		3	80		8	454
WI	60	2,748		2	132		16	1,194
WV	42	4,065		6	625		27	2,493
WY	23	959		2	57		0	0
Total	**3,224**	**244,107**		**221**	**19,113**		**776**	**77,814**

* Completed projects includes all properties reviewed through Mark-to-Market to date, including Full and Lite restructurings, discontinued restructurings, and rent comparability studies. As stated in the testimony text, properties preserved to date, i.e. Full and Lite restructurings, total 2,177 properties with 188,838 units.

** Current Pipeline includes all properties currently active in Mark-to-Market.

*** Potential Referrals includes all projects eligible for Mark-to-Market FY 07-11 based on current eligibility requirements.

PREPARED STATEMENT OF CHRIS FOSTER

PRESIDENT, NATIONAL LEASED HOUSING ASSOCIATION

JUNE 14, 2006

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to testify on legislation to extend HUD's Mark-to-Market restructuring program from its current expiration date of October 1, 2006. My name is Chris Foster and I am President of Hampstead Partners. I am testifying today on behalf of the National Leased Housing Association, a trade association located in Washington, D.C., which for over 35 years has represented owners, managers, investors, lenders and public agencies involved in developing and preserving affordable multifamily housing primarily assisted under housing programs administered by HUD.

We strongly support the extension of the Mark-to-Market program. It is a valuable tool that has resulted in the preservation of over 200,000 affordable rental apartments as well as resulted in significant savings to the Federal Government. The Mark-to-Market program applies to properties, insured by the Federal Housing Administration (FHA) with project-based assistance primarily under Section 8 of the United States Housing Act of 1937, and with rents in excess of rents for comparable unassisted units in the area. Notwithstanding the fact that many of these properties had originally been built with rents which were set above market, when the first wave of 20-year Section 8 contracts approached expiration in the mid 1990s, Congress was reluctant to authorize renewal of the contracts at above-market rents. Many of these projects could not operate and meet mortgage payments at market rents. A large number of these projects were financed with HUD-insured mortgages. This universe of projects lent themselves to a solution with a positive budget impact, restructuring of the HUD-insured mortgage by a full or partial payment of insurance claims, thereby lowering debt-service to a level that was sustainable at market rents. In addition, needed rehabilitation and the replenishment of reserves is generally accomplished under the program through further reductions in existing debt to permit new debt to be increased to cover these costs which are necessary to ensure continued operations. Owners of projects that have been restructured must execute use agreements to accept Section 8 renewal offers and to keep rents affordable, with or without the availability of Section 8 assistance, for 30 years.

We understand that in the coming years a significant number of Section 8 contracts will be eligible for initial renewal and that many are attached to projects with HUD-insured mortgages.

The same factors that moved Congress to enact the Mark-to-Market program in 1997 and to extend it in 2001 exist today and warrant a further extension. **We urge Congress to authorize a 5-year extension of HUD's restructuring authority and have attached for the record an industry letter signed by 15 national housing organizations that endorse such an extension.**

The bill proposes two changes to the Mark-to-Market program that we strongly support. The Mark-to-Market Extension Act increases from 5 percent to 9 percent the total number of units that can have exception rents in excess of 120 percent of the fair market rent for the area. Exception rents are budget-based rents that exceed market rent and are used when no amount of debt restructuring can yield viable rents that are below market. The 5 percent limit was basically an educated guess when it was enacted in 1997 and HUD's experience with that limit over the years should be acknowledged. A second revision included in the bill would extend the 3-year period during which a nonprofit purchaser of a Mark-to-Market project can obtain relief from a second mortgage on the project to 5 years from the date of recordation of the affordability agreement or 2 years from the date of enactment of the bill. A longer time frame is necessary to recognize the reality of real estate acquisition timeframes and will encourage major recapitalization of the properties.

We recommend adding a provision to the bill to give owners of properties that have undergone debt restructuring the right to request and receive budget-based rent increases. Such rent adjustments are authorized in the Mark-to-Market regulations but discretionary and HUD has determined not to entertain any request for budget-based rent adjustments, relying instead solely on an annual Operating Cost Adjustment Factor (OCAF). Over the 30-year life of the program, it is possible that for some properties the OCAF adjustment will be insufficient to meet rising operating costs which does not necessarily reflect actual operating expense increases particularly because OCAFs are published on a state-wide basis. This flexibility is also particularly important as it relates to properties that were underwritten before March of 2002 when HUD amended its underwriting criteria to allow a sufficient cushion for operating cost increases. In order to maintain project viability, owners should have the option of a budget-based review of rents in those circumstances.

Further, there also may be situations that will require additional restructuring of such projects.

The bill also proposes one change to the authorizing statute that moves the program into new areas and which we are not able to endorse at this time. Section 6 of the bill as drafted would give HUD the unilateral authority to require Section 8 projects with HUD-insured loans, *but with below-market rents,* to participate in the Mark-to-Market program or lose their Section 8 assistance. This is a major departure from the current program and we are not aware of any compelling evidence to justify such a change. Any proposal that makes a fundamental change to current law and practice should not be included as an amendment to an extension bill and should be thoroughly vetted as part of a separate legislative initiative. For nearly 9 years we have had stable and predictable rules for Section 8 renewals that work well. An extension of theMark-to-Market program beyond its original scope can cause confusion and is overreaching, potentially leading to an increased number of owners opting out of the Section 8 program.

Properties with rents below comparable market rents have options to address rehabilitation needs and we prefer the use of existing tools rather than change the framework of the current Mark-to-Market program. In fact, we encourage the Department to review its existing tools including the ability to include new debt service in budget-based rent adjustments (not to exceed comparable market rent) as part of transactions that will accomplish significant rehabilitation to ensure long-term viability and preservation. Further, NLHA recommends that HUD assign nonMark-to-Market preservation transactions (property disposition, 236 decouplings, loan work-outs, *etc.*) to the Office of Affordable Housing Preservation (OAHP) which now administers the Mark-to-Market program. Due to its responsibilities related to mortgage restructuring, the OAHP office is staffed by sophisticated real estate professionals who understand the intricacies of preservation restructurings and would be well suited to process other complex transactions.

Thank you for your time and consideration. I will be glad to answer any questions.

April 19, 2006

Hon. WAYNE ALLARD,
U.S. Senate
521 Senate Dirksen Office Building
Washington, DC.

Dear Senator Allard:

We are writing to express support for legislation that will further efforts to preserve the assisted housing inventory by extending the authority of the Department of Housing and Urban Development (HUD) to restructure FHA-insured mortgages under the "Mark-to-Market Program." This program was authorized in 1997 under the Multifamily Assisted Housing Reform and Affordability Act (MAHRA) as part of an effort to address the expiration of rental subsidy contracts under the Section 8 project-based programs. The legislation resulted in a program that allowed for the restructuring of mortgages on projects with above-market rents, to reduce such rents in exchange for an extended affordability term of 30 years. HUD has preserved over 3,000 projects as part of this program.

The authority for HUD to restructure such mortgages expires on September 30, 2006. We urge Congress to provide for a 5-year extension of the contract in order to preserve an additional 1,000 properties that are expected to be eligible for the debt restructuring program during that timeframe. We believe such an extension will not result in any increased costs to the Federal Government and, in fact, may result in Section 8 rent savings in the future.

Thank you for your interest and commitment to preserving the affordable housing stock. We stand ready to work with you to ensure the extension of the September 30, 2006 deadline. Please contact Denise B. Muha at NLHA with any questions or for more information (202–785–8888).

Sincerely,

AMERICAN ASSOCIATION OF HOMES AND SERVICES FOR THE AGING (AAHSA)
COUNCIL FOR AFFORDABLE AND RURAL HOUSING (CARH)
INSTITUTE OF REAL ESTATE MANAGEMENT (IREM)
INSTITUTE FOR RESPONSIBLE HOUSING PRESERVATION (IRHP)
MORTGAGE BANKERS ASSOCIATION (MBA)
NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION (NAHMA)
NATIONAL APARTMENT ASSOCIATION (NAA)
NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS (NAAHL)
NATIONAL ASSOCIATION OF HOMEBUILDERS (NAHB)
NATIONAL ASSOCIATION OF REALTORS (NAR)
NATIONAL HOUSING CONFERENCE (NHC)
NATIONAL HOUSING TRUST (NHT)
NATIONAL LEASED HOUSING ASSOCIATION (NLHA)
NATIONAL LOW INCOME HOUSING COALITION (NLIHC)
NATIONAL MULTI HOUSING COUNCIL (NMHC)
STEWARD OF AFFORDABLE HOUSING IN THE FUTURE (SAHF)

PREPARED STATEMENT OF SCOTT KLINE

VICE PRESIDENT AND DEVELOPMENT DIRECTOR, NATIONAL HOUSING TRUST

JUNE 14, 2006

Chairman Allard, Ranking Member Reed, members of the Subcommittee, thank you for inviting the National Housing Trust to participate in this hearing today. The National Housing Trust appreciates the opportunity to comment on the bill introduced by Senator Allard to extend the Mark-to-Market program of the Department of Housing and Urban Development.

My name is Scott Kline, and I am Vice President of the National Housing Trust, a national nonprofit organization formed in 1986, dedicated exclusively to the preservation and improvement of affordable, federally assisted and insured housing. Our board of directors includes representatives of all major interests in the field, including owners and managers, state housing finance agencies, national and regional nonprofit intermediaries, housing scholars and other housing professionals who care deeply about protecting this irreplaceable resource. The Trust was deeply involved in the introduction of the Mark-to-Market legislation nearly a decade ago and continues to view the program as an essential tool in the ongoing efforts to preserve existing affordable housing for working families and elderly people in all parts of this country.

The National Housing Trust serves as an informational clearinghouse on developments for the public and private sector. In addition to its public policy and program monitoring role, the Trust provides technical assistance to nonprofits on sale transactions of federally assisted and insured developments.

I also serve as the head of NHT/Enterprise Preservation Corporation, a housing development corporation that has used the Mark-to-Market program to successfully save affordable housing. NHT/Enterprise Preservation Corporation owns and operates nearly 3,000 affordable apartments in Illinois, Texas, Florida, South Carolina, North Carolina, Virginia, and the District of Columbia. NHT/Enterprise is a collaboration of the National Housing Trust and Enterprise Community Partners. The John D. and Catherine T. MacArthur Foundation provides NHT/Enterprise and the Nation Housing Trust general operating support and low-cost capital for housing development as part of its major national housing preservation initiative, *Window of Opportunity*.

As you know, the Mark-to-Market program was somewhat slow to get off the ground but, as I will make clear today, the program is currently a viable, mature, Federal housing preservation program—one that both saves housing and taxpayer dollars. According to the June 2006 version of HUD Research Works, depending on how one calculates the savings, the net present value of savings from the program range up to $883 million. *See Exhibit A.* For this reason alone, we strongly support the Senate bill.

Mark-to-Market Reauthorization Is Urgently Needed

On September 30, 2006, legislative authority for HUD's Mark-to-Market mortgage restructuring program expires. Without action by Congress to extend the program, apartments with HUD-approved rents that exceed comparable market rents face an uncertain fate. The National Housing Trust has joined more than a dozen housing groups in signing a letter supporting reauthorization (*See Exhibit B*).

The Mark-to-Market program preserves and improves affordable, HUD subsidized housing. Through a restructuring of debt and lowering of Section 8 contract rents, the Mark-to-Market program places HUD subsidized properties on a steadier financial platform from which they can be soundly operated with renewed, long-term affordability. Currently, an estimated 92,000 units in more than 1,000 FHA-insured properties have above-market rents.* Most of these properties, however, have contracts expiring after Mark-to-Market is scheduled to sunset. The problem: even if HUD's ability to restructure these properties' loans to supportable levels is not extended, HUD is obligated by law to lower above-market Section 8 rents. If this comes to pass, many property owners won't have sufficient revenue to cover operating costs and mortgage payments after their rental assistance is cut. The result: loss of affordable housing due to property deterioration and foreclosures.

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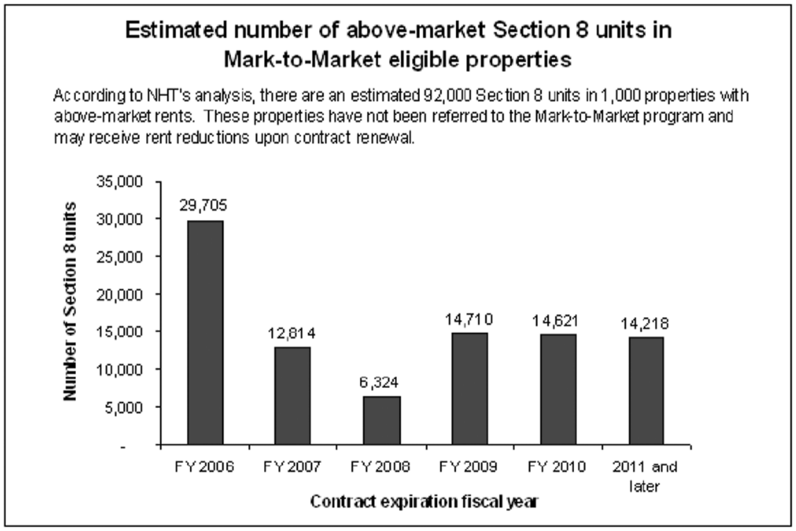
*Based on NHT's analysis of HUD data. Above-market status was determined by the FMR ratio (the ratio of the contract's rent gross amount to the FMR gross amount). For the purposes of this analysis, a contract with an FMR ratio greater than 105 was considered to have contract rents above-market.



Why Preserve Federally Assisted Housing Stock?

The nation's market supply of affordable housing does not currently meet the demand for that product. There is virtually no dispute that affordable housing is a precious and endangered resource. According to a recent report by the Joint Center for Housing Studies at Harvard University, the national goal of decent and affordable housing for all Americans remains out of reach for certain Americans because poverty persists and the Nation is losing low-cost rental units from the conventional housing inventory. The nation's low-cost housing stock declined by 2 million units between 1993–2003.[1] Thus, how HUD handles restructuring and continued affordability for the people who reside in the hundreds of thousands of apartments subsidized by HUD is a key concern for those of us concerned about the well being of low-income families.

No one disputes that the Mark-to-Market program has saved affordable subsidized housing. As of February 2006, the program had saved over 220,000 affordable apartments. Moreover, the program lowers the ongoing cost of keeping that housing affordable. In April 2006, the GAO issued a report titled "Policy Decisions and Market Factors Explain Changes in Cost of the Section 8 Programs." The report describes Mark-to-Market as one of the steps Congress and HUD have taken to limit costs (GAO Report, April, 2006: "Policy Decisions and Market Factors Explain Changes in Cost of the Section 8 Programs"):

> Congress and HUD have taken steps to limit further growth in the budgetary costs of the Section 8 programs . . . for the project-based program, Congress and HUD continued steps begun in 1997 to reduce above-market rents at some properties and to limit annual rent increases. (*See Exhibit C*).

By already preserving over 220,000 affordable apartments, the Mark-to-Market program has helped save an otherwise irreplaceable housing resource at an acceptable cost to the American taxpayer.

The Senate Bill Helps the Nation Resolve an Affordable Housing Dilemma at an Affordable Cost

According to a recent study conducted by HUD's Office of Policy, Development, and Research, 220,000 affordable housing units have been preserved since the program was first authorized in 1997, and rent reductions have resulted in up to $883 million in savings to the taxpayer. More than 2,800 properties have completed the Mark-to-Market process as of February 15, 2006. (*Supra, Exhibit A.*).

[1] America's Rental Housing: Homes for a Diverse Nation, p.1, Joint Center for Housing Studies (2006).

The HUD finding is consistent with historical Mark-to-Market cost estimates. In 2001, the Government Accountability Office (GAO) conducted an analysis to determine if the Mark-to-Market program should be extended past an earlier expiration date. The GAO conclusion: extending the program was more advantageous to the Federal Government than ending it. The reasons: cost savings in the Section 8 program, minimized loss claims on the FHA insurance fund, and preservation of the affordable housing stock.[2] That same year, the CBO found that "the cost of restructuring mortgage debt is less expensive than the cost of default by about $1 million per project, on average."[3]

Outline of the Proposed Bill

The Senate bill provides certainty to the marketplace that the Mark-to-Market program will continue. Extension of the program helps resolve a major housing dilemma for the households who live in properties where the Section 8 contract rent is higher than market. Moreover, the Senate legislation both identifies and helps resolve key issues of concern to those of us committed to affordable housing preservation. Specifically, the legislation:

- Continues the current program, which permits HUD properties to receive property-based assistance, albeit at lower levels than the current assistance.
- Recognizes that some properties may not be able to meet operating expenses at the post restructured market rent and permits rents to be set at a budget-based "exception rent" for up to 9 percent of the projects;
- Permits HUD, at its discretion, to use the Mark-to-Market restructuring authority on projects with at or below market rents;
- Provides for the preservation and rehabilitation of properties damaged by hurricanes or other natural disasters; and
- Extends the period during which a qualified nonprofit may purchase a Mark-to-Market property.

We support efforts in the Senate bill to address these important issues.

1. Exception Rents are a Vital Preservation Tool

Nationwide, no more than 5 percent of the properties in the Mark-to-Market program may have exception rents (defined as rents above 120 percent of Fair Market Rent). This authority may be exercised only if the loss of the project would seriously impact the tenants and community and the net operating income of the project is insufficient to support reasonable expenses and operating reserves. The Senate bill lifts this exception rent cap up to 9 percent of the properties closed under the program in any given year. NHT/Enterprise was recently involved in a transaction that could not have occurred absent the provision of exception rents.

In June, 2005, NHT/Enterprise closed on the financing of a 67-unit, 100 percent Section 8, scattered-site property located in the South Shore neighborhood of Chicago. The properties, known as the "O'Keefe Portfolio," were acquired and renovated using financing and pursuant to the program requirements of HUD's Mark-to-Market Program. The South Shore neighborhood is in a working class community. One of the properties has 20 townhouses. Others are vintage 1920's Chicago brick multifamily neighborhood buildings. There is a strong conversion market for these types of walk up buildings due to favorable real estate tax treatment that such buildings receive upon condominium conversion. Absent the Mark-to-Market Program and its allowed use of exception rents, these 67 affordable apartments could have been converted to market-rate housing. The families occupying the housing all earn less than 30 percent of median income.

The O'Keefe Portfolio was preserved as affordable housing utilizing the Mark-to-Market program and exception rents.

Under the restructuring, the new marked down rents were sized at 110 percent of Fair Market Rent, an amount sufficient to pay operating expenses and service $1.1 million in debt. Rehabilitation and repair work financed under Mark-to-Market restructuring includes new windows, new roofs, lead based paint remediation, new or enhanced furnaces, porch repairs, concrete and asphalt repairs, masonry repairs, addition of a management office and computer lab for use by residents, and numerous interior improvements such as new kitchen cabinets, new appliances, new carpet/tile, plaster repair and paint, and new tub surrounds.

Attached as *Exhibit D* is an example of how another national nonprofit organization, Volunteers of America, employed Exception Rents to save HUD-assisted housing. Permitting exception rents for up to 9 percent of the properties that are restructured permits organizations like VOA and NHT/Enterprise to save more Mark-to-

[2] GAO Report: Issues Related to Mark-to-Market Program Reauthorization (July 2001).
[3] CBO Cost Estimate, H.R. 2589, Office of Multifamily Housing Restructuring Act, 2001.

Market properties. We thank the Chair for inserting this key provision on exception rents and urge the Senate to adopt it.

Separately, we recommend adding a provision to the Senate bill to give owners the right to request and receive budget-based rent increases. Such rent adjustments are authorized but discretionary with HUD. HUD has determined not to entertain any request for budget-based rent adjustments, relying instead solely on an annual Operating Cost Adjustment Factor (OCAF) adjustment. Over the 30-year life of the program, situations may arise where an OCAF adjustment is insufficient to meet rising operating costs, particularly for those properties that were underwritten before March 2002 when HUD amended its underwriting criteria to allow a sufficient cushion for operating cost increases. In order to maintain project viability, owners should have the option of a budget-based review of rents in those situations.

2. The Senate Wisely Includes the Provision Providing HUD the Authority To Use the Restructuring Tool for Otherwise Eligible Projects with At- or Below-Market Rents

The Trust supports this provision. While the relationship of rents to debt is one factor in determining the need for a restructured mortgage, it is not the only factor. From time to time, the government could restructure debt to save a property where the rents were previously below market but where rehabilitation of the property would push the rents higher than market. Application of the MAHRA statute tools will support a property's extended viability and renewed affordability. In exchange, the property owner should commit to an extended affordability period.

3. The Senate Bill Properly Includes a Provision Providing HUD the Authority To Use the Restructuring Tool for Otherwise Eligible Projects With At- or Below-Market Rents

While the relationship of rents to debt is one factor in determining the need for a restructured mortgage, it is not the only factor. From time to time, the government could restructure debt to save a property where the rents were previously below market but where rehabilitation of the property would push the rents higher than market. Application of the MAHRA statue tools will support a property's extended viability and renewed affordability. In exchange, the property owner should commit to an extended affordability period.

This recommendation was first suggested to Congress by SAHF, Stewards of Affordable Housing for the Future (SAHF—say "SAFE"). SAHF's positions on Mark-to-Market are *attached at Exhibit E.* NHT/Enterprise is a member of SAHF. SAHF's remaining members include Mercy Housing, Inc., National Affordable Housing Trust, National Church Residences, Preservation of Affordable Housing, Inc., Retirement Housing Foundation, and Volunteers of America. Collectively, SAHF members own and operate over 800 affordable properties in 48 states, Puerto Rico, the U.S. Virgin Islands and the District of Columbia.

4. The Trust Supports Extending the Period of Eligibility for a Nonprofit To Receive Debt Relief or Assignment When Acquiring a Mark-to-Market Property

The original Mark-to-Market bill encouraged transfers to qualified nonprofit organizations.[4] There is mounting nonprofit interest and ability to purchase Mark-to-Market restructured properties. State and local governments have successfully utilized nonprofit organizations to preserve and produce housing with tax abatement and relief, tax-exempt financing, HOME, CDBG, and the low-income housing tax credit. Nonprofit sponsors annually produce or preserve over 30,000 units of affordable housing. Where local capacity isn't available, regional and national nonprofit organizations have acted as developers and purchasers.

HUD limits the time a nonprofit may secure debt relief or assignment of debt on a Mark-to-Market property to *3 years* after the property closed under the program. *However, the Mark-to-Market program is nearly 10-years old.* With each passing year, qualified nonprofits are prevented from pursuing the elimination of debt in many properties that have previously passed through Mark-to-Market. Without nonprofit debt assignment or relief, these transactions are infeasible.

The 3-year rule significantly limits the options of private owners of these properties. Many owners are willing to transfer the properties. However, they are blocked from receiving a fair-market bid by the arbitrary 3-year limit. The current 3-year limit on these nonprofit purchase incentives is arbitrary, bearing no relation to when an owner ultimately decides to sell. If the best outcome at the time of sale

[4] HUD strictly defined the term "qualified." The Trust supports limiting debt relief to qualified organizations, as defined. See Appendix C to Mark-to-Market Operating Procedures Guide.

is transfer to a nonprofit purchaser, then the Secretary should have maximum flexibility to support that outcome.

The Senate bill appropriately addresses this policy flaw, permitting nonprofits to purchase a Mark-to-Market property on or before the later of 5 years after recordation of the affordability agreement or 2 years after enactment of the bill.

Again, thank you for providing the National Housing Trust an opportunity to provide comments on the Senate bill concerning the reauthorization of authority for restructuring of HUD-assisted and -insured housing.

Summary Statement of National Housing Trust

Mark to Market Reauthorization is Urgently Needed

On September 30, 2006, legislative authority for HUD's Mark-to-Market (M2M) mortgage restructuring program expires. Without action by Congress to extend the program, apartments with HUD-approved rents that exceed comparable market rents face an uncertain fate. The nation's market supply of affordable housing does not currently meet the demand for that product. There is no dispute that affordable housing is a precious and endangered resource. According to a recent report by the Joint Center for Housing Studies at Harvard University, the nation's low cost housing stock declined by 2 million units between 1993-2003. By already preserving over 220,000 affordable apartments, the Mark to Market program has helped save an otherwise irreplaceable housing resource at an acceptable cost to the American taxpayer.

The Senate Bill Resolves an Affordable Housing Dilemma

At an Acceptable Cost

According to a recent study conducted by HUD's Office of Policy, 220,000 affordable housing units have been preserved since the program was first authorized in 1997 and rent reductions have resulted in up to $883 million in savings to the taxpayer.

The Trust Has Successfully Used the Mark to Market Program to Save Affordable Housing in Chicago, Illinois.

We Support the Bill's Expansion Exception Rents and the Proposed Extension of Eligibility for Nonprofits to Secure Debt Relief.

Mark-to-Market Preserves Affordable Rental Housing

In the 1980s, HUD faced a serious challenge in our efforts to preserve the supply of affordable rental housing. Policymakers were concerned that a growing disparity between HUD-approved rents and market-rate rents would lead property owners participating in HUD's Section 8 subsidy program for low-income renters to leave the program. Others were concerned that HUD's rent subsidy costs were rising at a rate that, if it continued, would become far too costly. This situation can be traced to initial rent levels for Section 8 properties established back in the 1970s and early 1980s. Back then, rents were often set above local market levels to compensate for administrative costs, higher construction costs, and special features for the elderly.

In 1997, Congress authorized the Mark-to-Market (M2M) program in response to these concerns. Its first objective was to reduce rents to market level rates in Section 8 properties with FHA-insured mortgages. In some instances, rents were reduced without further negotiation or long-term commitment from the owner. In many cases, this would have thrown a project into default, unable to meet expenses with reduced income. In response, M2M authorized partial or full payment of mortgages from the FHA Insurance Fund as a means of reducing the size of the first mortgage debt. This type of debt restructuring replaces the old with a new mortgage and smaller mortgage payments that reduced rents can cover (plus expenses). The Section 8 subsidy is then decreased and HUD saves money. The owner agrees to retain the property as affordable rental housing for 30 years, thus meeting the second objective of M2M: that of preserving affordable rental housing. Additional provisions allow: (1) repair and replacement to upgrade or sustain a property's condition, and (2) above-market rents where affordable housing is needed and a property cannot be made financially viable at the market rate.

HUD recently arranged for an independent evaluation of M2M performance over time that focused on administrative aspects of the program, statistical analyses, and in-depth case studies which demonstrated how the program was operating. By the end of July 2003, 2,416 properties had worked with the M2M program after their original Section 8 contracts expired. The properties represented 25 percent of the assisted housing stock. Owners of the remaining stock have the opportunity to go through the M2M process

Debt restructuring of Section 8 properties can help preserve affordable housing rental stock for decades to come.

as their contracts expire. Projected cost savings from completed M2M restructurings were calculated in three ways, based on differing financial performance scenarios. For the properties processed through M2M by the end of July 2003, these scenarios produced a range of anticipated net savings to HUD that ranged from $111 million to $883 million over the next 20 years.

Based on an exhaustive review of actual outcomes, researchers concluded that M2M's restructuring process appeared to be effective in preserving affordable housing. Few properties that entered the M2M process had left the Section 8 program. Initial owner resistance to negotiating the restructuring of their contracts with HUD had largely dissipated, and the financial arrangements negotiated appeared to be sound. Section 8 tenants were able to remain in their homes, while enjoying physical improvements to the property. Moreover, the government was saving money.

Lynn Acres, in Shelbyville, Kentucky, is considered one of the success stories that illustrate M2M's purpose — to improve the financial viability of the property while preserving affordable rental housing. Lynn Acres has 40 Section 8 subsidized units occupied by a mix of young families, single mothers, and elderly tenants. The current owners built the project 20 years ago under the HUD-financed 223(a)(7) program. At the point of entry into the M2M restructuring process, both assessors and tenants rated Lynn Acres' condition as good, although it was in need of some repair and rehabilitation. This was similar to what was found

continued on page 5

EXHIBIT A

NATIONAL
HOUSING
TRUST

May 22, 2006

Senator Wayne Allard
Chair
Subcommittee on Housing and
Transportation
Senate Dirksen 534
Washington, DC 20510

Dear Senator Allard:

The organizations signing this letter are fully supportive of your intention to introduce legislation that extends the current Mark to Market program for five years.

We thank you for your leadership on this important affordable housing preservation issue.

Very truly yours,

Michael Bod

Michael Bodaken
National Housing Trust

cc:

National Housing Conference
National Affordable Housing Management Association
National Low Income Housing Coalition
National Housing Law Project
Stewards of Affordable Housing for the Future
Enterprise Community Partners
Local Initiative Support Corporation
California Housing Partnership Corporation
Chicago Community Development Corporation

EXHIBIT B

United States Government Accountability Office

GAO

Report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

April 2006

RENTAL HOUSING ASSISTANCE

Policy Decisions and Market Factors Explain Changes in the Costs of the Section 8 Programs

G A O
Accountability * Integrity * Reliability

GAO-06-405

EXHIBIT C

outlays dropped from $8.3 billion to $7.8 billion, a decrease of 6 percent. The growth in voucher outlays, however, significantly outpaced the rate of inflation, increasing from $8.5 billion to $14.6 billion (71 percent) in inflation-adjusted dollars.[22] Additional information on outlays in nominal and inflation-adjusted dollars appears in appendix IV.

Policy Decisions and Market Factors Drove Increases in Section 8 Outlays, but HUD and Congress Have Acted to Limit Further Growth

A number of policy decisions and market factors contributed to the growth in total Section 8 outlays from 1998 through 2004, including decisions to expand the number of households receiving vouchers, increases in the average rental subsidy per household, and other program costs. Figure 7 shows the general relationship between these policy decisions and market factors and Section 8 outlays. Although these factors also affected budget authority, our analysis focuses on outlays because, unlike budget authority, outlays occur when payments are made and thus reflect the actual annual cost of providing rental assistance. Congress and HUD have taken steps to limit further growth in Section 8 program costs—for example, by changing the program's funding formula for vouchers.

[22]Outlays for 2004 in inflation-adjusted dollars differ from those in nominal dollars because any payment made in the first three quarters of 2004 has been adjusted to reflect inflation occurring prior to the last quarter.

Parkway Towers: Case Study Involving Exception Rents

Located in downtown Cincinnati, Parkway Towers was built in 1915 to house single, female employees of Proctor & Gamble. Over time, the property evolved into a residence for members of downtown Cincinnati's homeless population. By 2001, the property and the project-based Sec. 8 attached to each of its units were at risk of loss from the affordable inventory, primarily due to poor management.

Using HOME funds from the Ohio Housing Finance Agency, SAHF member Volunteers of America (VOA) acquired the property in 2002 from its for-profit owner. The property had above-market rents, and the owner preferred to sell rather than go through Mark-to-Market (M2M) restructuring. The National Affordable Housing Trust, a not-for-profit financial intermediary (and SAHF member), served as a consultant to VOA on the acquisition/rehab.

At the time of the acquisition, the property housed disabled and elderly residents, many of whom faced mental and physical challenges that put them at continued risk of homelessness. Resident incomes averaged 35 percent of the area median gross income.

The acquisition involved extensive rehabilitation. Roofing, brick walls, drains, and siding were repaired. ADA building access was provided. Within the building, concrete beams, window sills, acoustic tiles, kitchen cabinets and sinks, and many stoves and refrigerators were repaired or replaced. Five of the units were made fully ADA compliant. Energy-efficient windows were installed. VOA also complied with the requests put forth by HUD as part of the M2M restructuring. These included furnishing and installing new window air-conditioners in each unit, upgrading the electrical service, installing a fire alarm and security system, and upgrading elevator controls to be ADA compliant. HUD also requested that VOA convert four of the dwelling units to office spaces. Thanks to an award of McKinney-Vento funds, which VOA pursued through the Cincinnati Continuum of Care, service coordination and private case management services are now provided from this area.

Parkway Towers's M2M restructuring involved a full payment of claim, leaving the property with no hard debt and therefore no debt-service payments. Despite this fact, market rents in the area were too low to support property operations. At market rents, the property would have lost approximately $30,000 per year on operations alone. The property could not have been preserved without exception rents.

The chart below shows how rents at the property changed from pre- to post-M2M restructuring.

Unit Type	# Assisted Units	Pre-M2M Rent	Market Rent	Exception Rent	Savings (pupm)	Savings (annual)
0BR	17	$435	$300	$376	$59	$12,036
1BR	68	$494	$375	$470	$24	$19,584
Total/ Wghtd. Avg.	85	$482	$360	$451	$31	$31,620

Even with exception rents, the restructuring resulted in a 6 percent savings in project-based Sec. 8 expenditures.

In addition to continuing to serve some of the most vulnerable residents of Cincinnati – at reduced cost to the taxpayer – Parkway Towers is credited with contributing to the improvement of the Over the Rhine neighborhood in which it is located.

EXHIBIT D

S A H F

Lessons from MAHRA: Preserving What Works

MERCY HOUSING, INC.

NATIONAL AFFORDABLE HOUSING TRUST

NATIONAL CHURCH RESIDENCES, INC.

NHT/ENTERPRISE PRESERVATION CORPORATION

PRESERVATION OF AFFORDABLE HOUSING, INC.

RETIREMENT HOUSING FOUNDATION

VOLUNTEERS OF AMERICA

The Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) was enacted with two goals in mind: (1) to eliminate above-market rents at properties with FHA-insured mortgages and project-based Sec. 8 assistance and (2) to preserve affordable rental housing in markets where it is needed. To achieve these goals, the legislation created a Mark-to-Market (M2M) program comprised of a set of preservation tools. These tools expire on September 30, 2006.

SAHF believes that the tools made available under the M2M program enable HUD to be a responsive and effective party to preservation transactions. In fact, a recent evaluation of the program found that it was effective in meeting its stated goals. SAHF urges that these tools should be made permanent and used to preserve a broader range of properties. SAHF's six-part proposal is summarized below.

1. **Make permanent HUD's authority to (a) enter into restructuring agreements and (b) provide exception rents.**

   Conventional multifamily housing expects a resale and recapitalization every 7 to 10 years at a minimum. For the subsidized, rent-assisted inventory, rehabilitation and recapitalization can result in continued affordability only when tools and policies are in place to support this outcome. Mark-to-Market debt-restructuring has proven to be such a tool. So, too, have exception rents in cases where the reduction from contract to market rents generates insufficient net operating income to cover operating expenses and reserve requirements, thereby eliminating the potential for preserving the affordability of these assets.

   > A number of projects that underwent "Lite" restructurings early in MAHRA's history are now up for contract renewal and once again have above-market rents.

   Deprived of these restructuring and rent-setting tools, HUD will become incapable of supporting the viability and continued affordability of properties that come in for contract renewal and have their rents reduced to market. Certainly, many such properties will struggle to service their FHA-insured debt. The same is true of some properties that have already been through the restructuring process, such as Watch List properties, those that underwent restructuring before important program refinements were adopted, and those that underwent erroneous restructurings. In the end, without a Mark-to-Market alternative, these properties could well end up in foreclosure, costing the federal government millions of dollars and / or eliminating their affordable use. By contrast, the M2M program has preserved more than 200,000 affordable apartments at an estimated cost savings of $1.6 billion, according to HUD.

2. **Expand the range of properties eligible for restructuring and exception rents.**

   A property's eligibility for debt restructuring and / or exception rents should be defined not according to an arbitrary deadline but based upon its physical and financial needs and the likelihood that the application of such tools will support the

STEWARDS OF AFFORDABLE HOUSING FOR THE FUTURE
1101 30TH STREET, N.W., SUITE 400 • WASHINGTON, D.C. 20007

EXHIBIT E

property's extended viability and renewed affordability. For this reason, SAHF supports extending *eligibility* for debt-restructuring and exception rents to properties that were originally deemed ineligible for restructuring: specifically, properties that underwent restructuring as part of the MAHRA demonstration program and ELIHPA or LIHPRHA[1] properties.

3. **Make permanent the HUD Secretary's ability to modify or assign secondary debt to nonprofit or nonprofit-controlled purchasers — or to forgive such debt entirely — and eliminate the current three-year limit on doing so.**

   As for-profit owners of restructured properties realize that the benefits of ownership have been reduced by the restructuring, they are more likely to sell. If these assets are to be preserved as affordable, their transfer to qualified nonprofit owners must be supported. SAHF believes that the Secretary's ability to modify, forgive, or assign secondary debt to nonprofit or nonprofit-controlled purchasers should be made permanent and extended indefinitely by statute. The current three-year limit on use of these nonprofit purchase incentives is arbitrary, bearing no relation to when an owner ultimately decides to sell. If the best outcome at the time of sale is transfer to a nonprofit purchaser, then the Secretary should have maximum flexibility to support that outcome.

   Under its "freeze the claim" policy, the Department itself derives a benefit from the use of these nonprofit purchase incentives. Under this policy, HUD performs a baseline analysis of the claim that would be paid under normal MAHRA procedures, then holds that amount constant before taking Low Income Housing Tax Credit (LIHTC) equity into account. The effect of this policy is to increase the average rehabilitation per unit of Mark-to-Market deals with LIHTC versus those without, further enhancing the physical and financial viability of properties and almost certainly lowering rental assistance needs. According to HUD, the average rehab. per unit for M2M deals without LIHTCs is $2,000. For those with LIHTCs, the number jumps to nearly $30,000.

4. **Transfer to HUD's Office of Affordable Housing Preservation (OAHP) the responsibility for refinancing the Sec. 202 portfolio, while maintaining Sec. 202 properties' exemption from restructuring.**

   The MAHRA legislation exempted from restructuring those properties financed under Sec. 202 of the Housing Act of 1959. SAHF believes that this exemption should remain in place but that the task of *refinancing* such properties should be transferred to OAHP.

   The team that was assembled at OAHP is characterized by its ability to appreciate the perspectives of various parties to transactions and to grapple with complex deal variations. Over time, it has refined the tools and policies put in place by MAHRA

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[1] Emergency Low Income Housing Preservation Act (ELIPHA, enacted in 1987) and Low Income Housing Preservation and Resident Homeownership Act (LIHPRHA, enacted in 1990).

in a manner that is supportive of the preservation mission while remaining responsive to the needs of the government, owners, sellers, purchasers, and lenders. The "freeze the claim" policy described above, for example, is a modification of an earlier policy that tended to negate the value to a property of funds coming into a deal from LIHTCs. OAHP staff have also developed a set of underwriting standards intended to promote the immediate interests of residents and the long-term viability of properties.

Much of the work of OAHP is accomplished by a network of participating administrative entities (PAEs), skilled third-party contractors that develop, negotiate, and implement restructuring plans with individual owners. HUD's August 2004 evaluation of the Mark-to-Market program found that the time it takes for PAEs to process restructuring plans has declined dramatically. Overall, HUD's restructuring team has gained the experience it needs to be highly effective in implementing a complicated program.

By contrast, the field office and headquarters staff currently charged with processing Sec. 202 refinancing requests is overburdened and generally inexperienced with LIHTCs and / or restructurings. Many field offices resist the use of LIHTCs with Sec. 202. Every transaction, no matter how small, is hand-crafted, with costs in time and money for both HUD and the sponsors. The Sec. 202 portfolio of approximately 4,300 properties constructed between 1959 and the early 1990s requires rehabilitation. OAHP staff could speed the processing of these transactions, reducing the time and expense required and enabling sponsors to realize the cost savings made possible by today's relatively low interest rates.

5. **Launch a demonstration program within OAHP to restructure properties with state-financed mortgages, project-based Sec. 8 assistance, and above-market rents.**

The MAHRA legislation, as amended, exempted primarily state-financed properties from mortgage restructuring if such a restructuring would conflict with the applicable laws or agreements governing such financing.[2] According to HUD data, however, there are approximately 250 properties with state-financed mortgages and project-based Sec. 8 assistance that have above-market rents.[3] At the high end, one property has a rent-to-FMR ratio of 242. Among all such properties, rents average 122 percent of the local Fair Market Rent (FMR).

For properties financed by state and local housing agencies that have above-market rents and project-based Sec. 8, the demonstration program might authorize HUD to deploy the FHA Insurance Fund to restructure the underlying debt, in exchange for cost savings on the Sec. 8 side in the form of lower rents.

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[2] Properties financed with state or local bonds are typically prohibited in the bond documents from entering into a Mark-to-Market restructuring.

[3] Another 2,000 state-financed properties occupied by tenants with vouchers have above-market rents. Rents for these units average 133 percent of the local FMR.

6. **Identify how best to deploy debt-restructuring and other tools to preserve rural housing, housing for the disabled, and single-room occupancy housing.**

   In addition to exempting from mortgage restructuring those properties financed primarily by state and local agencies and under Sec. 202 of the Housing Act of 1959, the MAHRA legislation also exempts properties financed under Sec. 515 of the Housing Act of 1949, Sec. 811 of the American Homeownership and Economic Opportunity Act of 2000, and Sec. 441 of the Stewart B. McKinney Homeless Assistance Act. SAHF affirms the inevitable need to recapitalize such properties and encourages Congress and the Department to explore how the tools tried and tested under MAHRA and refined by OAHP staff might best be deployed to protect the long-term viability of the properties and the affordable rents and stability enjoyed by residents.

* * *

SAHF (say "SAFE") is a 501(c)(3) membership organization comprised of nonprofit housing development and ownership entities who operate on a national scale. SAHF's members are Mercy Housing, Inc.; the National Affordable Housing Trust; National Church Residences, Inc.; the NHP Foundation; NHT/Enterprise Preservation Corporation; Preservation of Affordable Housing, Inc.; Retirement Housing Foundation; and Volunteers of America. Combined, SAHF's members own more than 62,000 affordable rental homes in 46 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Funding to launch SAHF was provided by The John D. and Catherine T. MacArthur Foundation and SAHF's members.